MINUTES
of the
FIFTH MEETING
of the
ECONOMIC AND RURAL DEVELOPMENT COMMITTEE

October 25-26, 2007
Room 307, State Capitol
Santa Fe, New Mexico

The fifth meeting of the Economic and Rural Development Committee was called to order by Senator Bernadette M. Sanchez, chair, on October 25, 2007 at 9:30 a.m. in the State Capitol in Santa Fe, New Mexico.

Present
Sen. Bernadette M. Sanchez, Chair (10-25)
Rep. Mary Helen Garcia, Vice Chair
Rep. Andrew J. Barreras
Rep. Richard J. Berry
Rep. Jose A. Campos (10-26)
Rep. Ernest H. Chavez
Sen. Dianna J. Duran (10-25)
Sen. Mary Jane M. Garcia (10-25)
Rep. Dianne Miller Hamilton
Sen. Clinton D. Harden, Jr.
Rep. Patricia A. Lundstrom
Sen. Richard C. Martinez
Sen. John Pinto

Absent
Sen. Phil A. Griego
Rep. Brian K. Moore
Sen. William E. Sharer

Advisory Members
Rep. Nathan P. Cote
Rep. Nora Espinoza
Rep. Daniel R. Foley (10-25)
Rep. William J. Gray
Sen. Carroll H. Leavell
Rep. John Pena
Sen. Lidio G. Rainaldi (10-25)
Rep. Debbie A. Rodella
Sen. John C. Ryan
Rep. John A. Heaton
Sen. Stuart Ingle
Sen. Timothy Z. Jennings
Rep. James Roger Madalena
Sen. Steven P. Neville
Rep. Andy Nuñez
Sen. Shannon Robinson
Rep. Richard D. Vigil

(Attendance dates are noted for members not present during the entire meeting.)

Staff
Kate Ferlic
Maha Khoury
Larry Matlock
Gordon Meeks
Chase Van Gorder

Special Guests from the Courts, Corrections and Justice Committee
Sen. Rod Adair (10-25)
Rep. Thomas A. Anderson
Sen. Cisco McSorley (10-25)
Rep. Al Park (10-25)
Rep. Sheryl Williams Stapleton (10-25)
Rep. Peter Wirth (10-25)
Rep. Eric A. Youngberg (10-25)

Guests

The guest list is in the meeting file.

Thursday, October 25

Committee Business

Senator Sanchez began by welcoming the committee members and guests.

Payday and Subprime Mortgage Lending

Superintendent Ed Lopez of the Regulation and Licensing Department (RLD) and Deputy Superintendent Pamelya Herndon were joined by Bill Verant, director of the Financial Institutions Division (FID), to present the committee with the current issues regarding payday and subprime mortgage lending.

Mr. Verant's handout listed the top five problems regarding subprime mortgage lending. They are:
1. Mortgage fraud against investors/lenders.
2. Unregistered loan originators.
3. Kickback fees and fee splitting.
4. Undisclosed fees.
5. Consumers' unfamiliarity with documents, terms and paperwork.

The handout also states that the RLD seeks to strengthen the Mortgage Loan Company and Loan Broker Act to amend, change, revise or enhance enforcement of state law to help the consumer.

Superintendent Lopez gave the committee a handout showing that while the number of total institutions regulated by the division nearly tripled from 1995 to 2007, the number of employees at the FID has actually decreased. Revenues collected by those employees has nearly doubled in that time, while the budget has increased from $1.1 million in 1995 to $1.7 million in 2007. Mr. Verant said he intends to ask for a supplemental appropriation for fiscal year 2008, and in fiscal year 2009 he will ask for one-third more money and eight more full-time employees.

Senator Sanchez noted that although new laws limit predatory lending, predatory practices will continue simply by lenders changing the name of their product from "payday" loans to "installment" loans. She noted there has been a 521% increase in installment loans since the attorney general posted the new rules and regulations for payday loans.

Mr. Lopez said that the most common tactic to get consumers to qualify for home loans was outright mortgage fraud by substituting "stated income" for the actual income. He noted that he had testified to the Legislative Finance Committee, and that in New Mexico the mortgage lending industry is regulating itself, with no outside agency watching over it.

Ms. Herndon gave details of some of the predatory lending practices that exist, including offering a higher interest rate when the client qualifies for a lower rate, or charging a fee for "finding" a loan for a well-qualified but financially ignorant client who could simply get that loan from a local bank. Another predatory practice loan brokers use is to write a loan where the payment does not include interest, taxes and insurance on the property. Uninformed consumers think their taxes are being paid. When the taxes and insurance come due, they cannot pay and are in jeopardy of losing the home, or their house burns down and they find out they do not have insurance.

Most of these clients are too poor to hire lawyers and cannot pursue legal remedies. The Mortgage Loan Company and Loan Broker Act focuses on brokers and loan originators, but does not provide specific remedies to consumers with financial products they cannot afford.

Representative Berry asked how the statutes and structure in New Mexico compare to other states. Mr. Verant responded that although New Mexico's laws are as good as those in other states, foreclosures on subprime loans are a national problem.

Representative Berry asked if borrowers are committing fraud with respect to "stated income", or if that responsibility rests on the shoulders of the loan broker. Mr. Verant responded that both are responsible, but that loan brokers turn around and sell the loans as soon as they are made and often are impossible to find when discrepancies in stated income and real income become apparent. The actual lender may not be aware that the stated income is incorrect

Senator Garcia asked who gets the kickback. Mr. Verant explained that some brokers extract an additional amount after the closing, which is not legal.

Representative Foley noted that four out of the "top five" findings are already illegal and asked why the laws are not being enforced. Mr. Verant replied that the FID simply does not have the resources and that the law enforcement powers reside with the attorney general.

Representative Foley recommended enforcing the current laws before rolling out new ones. Mr. Lopez pointed out that the RLD is starting to heighten enforcement with current resources.

The committee recessed for lunch at 11:43 a.m. and returned at 1:35 p.m.

Lending in the Courts

The Honorable William Lang, chief judge of the Civil Division of the Second Judicial District, presented the committee with information about the dramatic increase in the number of civil cases filed in the last five years related to contract debt, money due, credit card collection and bad car loans. Foreclosures are separated and, like student loans, are not part of the cases over which he presides.

In fiscal year 2005, 3,490 cases were filed. For 2006, the number of cases filed increased by 700, and reached 5,640 cases for the 2007 fiscal year. Other caseloads remained the same, including torts, automobile accidents, malpractice and general court cases. Collections cases make up the only area with a dramatic upsweep.

Representative Wirth noted that foreclosures are going down, which seems counterintuitive considering the plummet in the subprime market. Judge Lang explained that the real estate market cases are not limited to foreclosures. Breach of lease is also included in that category. Based on his 10 years of experience on the bench, it is his opinion that residential foreclosures have increased.

Representative Pena asked about the availability of statewide data. Judge Lang said he would request that information from the Administrative Office of the Courts, including the percentages for the number of cases appealed.

Representative Anderson noted that the educational system does not do much to educate the public about financial matters and asked if there is any form of financial rehabilitation for those who get deeply into debt. Judge Lang explained that the judicial system lacks the tools to keep those in debt from getting into the same situation again. In criminal cases, counseling can be made part of probation or parole requirements, but no such avenue exists to force defendants in civil cases to attend financial counseling. He said, "We don't send people to jail for not going to credit counseling. It is somewhat impossible."

Responding to a question from Representative Garcia, Judge Lang explained that the biggest increase is in the area of credit card defaults. Although car loan defaults have increased steadily, credit card defaults have skyrocketed.

Committee Business

Minutes of the second, third and fourth committee meetings were approved.

Subprime Lending from Consumer Advocates' Perspectives

Chris Kukla from the Center for Responsible Lending, Diane Dorn Jones from the Project

Change Fair Lending Center and Angelica Anaya Allen from the Senior Citizens Law Office gave the committee their views and seven handouts.

Mr. Kukla explained that 10 years ago, subprime loans made up less than 10% of the market, while that number hovers near 20% today. Lenders earned good fees by offering refinancing packages that had no real benefit to the borrower. Although rates can be refinanced, fees are gone forever.

He commended New Mexico's laws, saying that they are being used as a non-negotiable model for federal legislation.

Mr. Kukla told the committee how the subprime lending industry got into its current situation. Brokers would offer a 2/28 adjustable rate mortgage. The annual rate would remain the same for two years, usually around six to eight percent. After that, the rate would readjust every six months, causing an enormous payment shift, often doubling. Borrowers who could not make the payments had to refinance or sell the house. As long as prices kept going up, the loans could still function. Housing prices did not maintain their value, turning a generation of home buyers into renters. Refinancing was no longer an option once the houses had no equity and no market was available to rescue the borrowers from their continually increasing payments.

The overriding question for loan brokers was not, "Can the borrower make the payment?" Instead, the question became, "Will Wall Street buy this loan?" Loans were "securitized", meaning that thousands of similar loans were pooled and sold off in securities, based on risk. Loan brokers would sell the loan the day they made it, after adding as many extra fees onto it as they could.

Mr. Kukla recommended that New Mexico require lenders to take into account the ability of the borrower to repay the loan by verifying and documenting income, taking into account future interest rates. The state should also require escrow taxes on subprime loans, making sure the borrower can afford the payments as well as taxes and insurance. Finally, New Mexico should examine compensation, especially in the form of kickbacks for more expensive loan products. If a lender pays the broker a kickback for a more expensive loan, then the lender should be responsible for the acts of the mortgage broker, especially in the case of yield spreading.

Mr. Kukla doubted that financial literacy would solve the problem, because Countrywide Financial offers 205 mortgage products. The average consumer cannot develop the expertise to understand all of them.

Ms. Jones jokingly identified herself as a recovering banker who now serves on Governor Richardson's Task Force on Mortgage Lending. She noted that the banking community claimed that New Mexico did not have a mortgage problem, but that is because the charts they use do not include high-risk loans. Although the rate for a loan is supposed to be based on risk, some of the incredibly high rates being charged go far beyond the risk involved. Brokers steer their clients toward these risky loans. She gave the example of a receptionist who made $20,000 per year, which was not enough to qualify. The broker included her 19-year-old son's summer job income so she could qualify, and once he left home she could no longer make the payments. The son ended up with a bad credit report with a foreclosure on his record.

Banks are no longer willing to help work out payment plans, instead jumping straight to foreclosure. Ms. Jones has to help people transition out of their homes with some level of dignity. She said the growing number of foreclosures in the subprime market will impact the state's level of homelessness and domestic violence with even broader effects later as children grow up without feeling settled because their parents do not own a home. The next generation will continue to live in poverty because, while home ownership is supposed to pass wealth to the next generation, those that go through a foreclosure do not get that benefit for their children.

Many of her clients had no counseling when they got their first loan. Poor areas become targets for predatory lenders. Banks and the lending industry vigorously resist regulation. The states must push regulation to speed things up at the federal level.

Ms. Allen explained the heartbreaking difficulties of helping seniors who have been in their homes for 30, 40 or 50 years move out of their homes because they have no equity left. One of the reasons for this is the "reverse mortgage". Equity left in the property is used to pay off the loan until finally the borrower no longer has a home to live in or to leave to family members. She said that New Mexico's senior citizens would be well-served by a usury pact. Representative Wirth called it the "Pacman mortgage" because it just eats away at the equity until there is nothing left.

One broker, when faced with a client with poor credit, put down a fictitious son on the application. Although the broker committed fraud, the loan has now been sold three or four times. The subsequent mortgage holders are not liable for the initial broker's fraud.

In another case, a senior couple with great credit were convinced by a broker to consolidate all of their debt and qualified based on their employment earnings. At the time, they were 75 and 61 years old. The broker did not look at what their income level would be in two or three years. Once the husband quit working full time two years later, they could not make their payments and are looking at moving out of a home they have made payments on for the last 28 years. When they tried to refinance, they discovered the broker had inflated the value of the home. All their equity was gone and the bank carrying the debt said that the investors were not willing to renegotiate.

These tactics, which result in higher fees for brokers and higher foreclosure rates for borrowers, go against New Mexico's tradition of home ownership, where families keep their homes and land for many, many years.

Subprime Mortgage Lending Industry

Paul Boushelle from the New Mexico Banker's Association and Ben Hayward, CEO of the First Financial Credit Union, explained the evolution of the adjustable rate mortgage (ARM).

Wall Street and investors loved the subprime loans and ARMs. From the borrower to the broker to the lender to Wall Street, everyone was lying all the way down the line and now it is time to pay the piper. It finally stops with the lender, because the lender is the only one with any money left. Payments for a 2/28 ARM can jump from $1,200 to $1,800 in six months, with more increases until the home is repossessed.

Many people used ARMs to purchase houses with the intention of flipping them, selling them quickly for profit before the rate adjusted. Once the housing market bubble burst, they were stuck with payments they could not make for homes they could not afford to keep. They also thought their property would increase in value, which did not happen.

Low payments are used to lure borrowers into buying homes beyond their means. Regulations, no matter how good they are, cannot do much when the borrowers do not know what they are doing.

Mr. Hayward said the solution is regulation and education. Brokers sell high-interest loans to borrowers with poor credit. Brokers can make $12,000 per loan and close on 10 of them per week. Making $120,000 per week encourages brokers to stick borrowers with impossible loans.

He said there is not much the legislature can do for loans that are already on the books because the legislature cannot pass retroactive laws.

Representative Lundstrom gave the committee copies of a bill amending the Home Loan Protection Act that she will ask the committee to endorse.

Consumer Protection Issues

Karen Meyers, director of the Consumer Protection Division and an assistant attorney general, addressed the subprime mortgage industry and payday loan issues. She also served on Governor Richardson's Task Force on Mortgage Lending.

She said that Attorney General Gary King believes in regulation and education to solve some of the problems. Consumer protection laws must be enforced while also educating businesses that take advantage of consumers. Like the other presenters, she noted that once a borrower is in trouble, there are few resources available to help. Action must be taken before the loan is entered into.

She recommended expanding the capacity of counselors before the purchase of a loan, as well as providing more assistance to borrowers facing default.

She praised the Home Loan Protection Act, saying it has worked well for New Mexico. Unfortunately, it cannot help much with the circumstances because of the new set of problems associated with high interest loans and ARMs. The high rates are not covered or prohibited by the Home Loan Protection Act. The Office of the Attorney General proposes a separate law that addresses only subprime lending.

There is a gap of responsibility between the loan originator and the consumer. The loan originator has no fiduciary duty to advise the consumer. When foreclosure comes around, the originator is nowhere to be found. She recommended fixing that gap by requiring the originator to provide a rate and appropriate information, as well as requiring income verification.

Escrow accounts are also a problem recognized by the task force. Disclosure should include escrow as well, which is not currently required under New Mexico law.

More accountability should also be required. If a lender benefits from having a broker or loan originator moving someone into a higher-cost loan, the lender should be held accountable for taking advantage of the borrowers.

Representative Rodella asked for a list of brokers who are barred from doing business in the state of New Mexico.

The committee recessed at 4:51 p.m.

Friday, October 26

The meeting was called to order at 9:08 a.m. by Representative Garcia, vice chair. She welcomed the committee members and guests and asked them to introduce themselves.

Update on House Memorial 35

Secretary of Transportation Rhonda Faught was joined by her chief counsel, Germaine Chappelle, and Muffet Foy Cuddy for an update on the requirements of House Memorial 35 from the 2007 regular session. Her handout, "House Memorial 35 Transportation Technical Committee", is in the meeting file.

Secretary Faught explained the dramatic increase in the cost of materials, which has caused many cost overruns in the department's projects. She attributed the increase to supply and demand, because India is building an interstate system and buying large quantities of raw materials. She noted that some neighboring states are experiencing 80% increases in the cost of construction. The cost of asphalt has gone up 92%. New Mexico's Department of Transportation (DOT) has managed to keep some costs down by reducing the thickness of pavement used on the shoulders of many roads. The use of design options has put the DOT in the top five departments nationwide for efficient use of resources.

Her handout included a chart showing the cost of gasoline in each state, along with the gasoline tax charged by each state. There is no correlation between high gasoline prices and high gasoline taxes. New Jersey has the third lowest tax and New York has the third highest, and yet their prices are almost exactly the same. She explained that in New Mexico, 76% of the money collected from the 17 cents-per-gallon road tax goes into the State Road Fund and 24% goes into the Local Governments Road Fund.

In order to plug the hole left by diminishing federal funds, she recommended dedicating the road excise tax to the State Road Fund, as well as initiating a registration surcharge based on the weight of the vehicle being registered because heavier vehicles do more damage. Also, she wants to dedicate the gross receipts taxes on state highway projects to go into the State Road Fund instead of the general fund, which would generate $14 million.

Senator Harden asked how $136 million redirected from the general fund into the State Road Fund would be made up. Secretary Faught responded that, currently, the general fund has a surplus, but that will not always be the case. She had no proposals to fill the hole.

Representative Lundstrom said that the DOT had been shy about getting up to the money trough, and distributed a discussion draft of a bill (202.170449.2) that would transfer money from the general fund to the Tribal Infrastructure Project Fund, to be used only for transportation-related projects.

Regulatory Reform

Beverlee J. McClure, CEO of the Association of Commerce and Industry (ACI), and T.J. Trujillo, shareholder chair of ACI's Regulatory Committee, presented the committee with discussion drafts of two bills and one joint memorial, which they hope will be introduced during the 2008 regular session. The proposed legislation and their handout, "Regulatory Reform", are in the meeting file.

The joint memorial would request the New Mexico Legislative Council to convene a commission for the promotion of uniformity of legislation. One of the bills would amend this commission's duties and reporting requirements. The other would amend the State Rules Act and provide for a regulatory analysis and a regulatory agenda for each state agency.

The committee adjourned at 11:38 a.m.